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Witness: Janis E. Fischer
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

JANIS E. FISCHER

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2001-299

Jefferson City, Missouri
May 2001

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1
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4
5
6

TABLE OF CONTENTS OF
SURREBUTTAL TESTIMONY OF
JANIS E. FISCHER

PAYROLL EXPENSE..... 2

BONUSES AND INCENTIVE PAY 7

Surrebuttal Testimony of
Janis E. Fischer

1 annualization. The Staff has also agreed to amortize over five years the cost of
2 PriceWaterhouseCoopers LLP's audit of Empire's Centurion Customer Information
3 System and Empire's installation of PeopleSoft over five years. The Staff's initial
4 position removed the cost of these audits from test year outside service expense. This
5 amortization treatment resolves this issue from both the Staff and I believe Empire's
6 standpoint.

7 **PAYROLL EXPENSE**

8 Q. What does the Company's rebuttal filing state about the inclusion of
9 unfilled vacant positions in the annualization of payroll expense?

10 A. The rebuttal testimony of Company witness Mr. McKinney, page 4,
11 lines 18 through 23, states as follows:

12 Although Empire is making an effort to fill vacancies as
13 quickly as possible, some vacancies will remain on the
14 June 30, 2001 cut-off date. I would simply request that the
15 Staff, and ultimately the Commission, allow inclusion of
16 salaries in situations where Empire can clearly demonstrate
17 that an active search is ongoing, or that a vacancy occurred
18 due to the transfer of an internal applicant to fill an existing
19 vacancy.

20 Q. Will the Staff accept Empire's position that, by demonstrating an active
21 search is ongoing for a position vacancy, the position should be included in the payroll
22 annualization?

23 A. No. The Staff would not propose to include positions in annualized
24 payroll that are merely being advertised in newspapers, posted on union bulletin boards at
25 Empire or for which Empire can merely demonstrate an active search for filling vacant
26 positions. The Company, in response to Staff Data Request No. 312, dated March 14,
27 2001, identified only two positions that it intended to advertise prior to June 30, 2001.

Surrebuttal Testimony of
Janis E. Fischer

1 Positions that Empire is advertising and actively searching to fill can remain vacant for an
2 extended and indefinite period. It is possible that no qualified applicants will apply or
3 will be found after completing the interview process, for some positions. It is also
4 possible that, for some positions, Empire will make offers of employment to applicants
5 that will not ultimately accept them.

6 Q. Does the more occurrence of a vacancy require that the position be filled?

7 A. No. A position vacancy allows the Company the opportunity to reevaluate
8 whether the position is necessary for completion of specific job related tasks or whether
9 tasks can be assigned to other employees already employed by Empire. The
10 announcement of the proposed merger with UtiliCorp United, Inc. (UtiliCorp) in
11 May 1999 led to erosion of the employee count at Empire. While the UtiliCorp/Empire
12 merger was actively being pursued, Empire managed to complete tasks with the
13 employees that remained at the Company and by using part-time and temporary
14 personnel. Since the termination of the UtiliCorp/Empire merger, Empire has been in a
15 position to reevaluate the vacancies and determine if employees need to be hired to fill all
16 position vacancies or not. Efficiencies that may have developed at Empire during the
17 course of the UtiliCorp/Empire merger process in order to address the circumstance of
18 unfilled vacancies that occurred as a result of, or were created by, the planned merger
19 may have lead to fewer positions being required than were budgeted at Empire before the
20 merger. Empire's rate case payroll annualization includes all of its 1999 budgeted
21 positions. The Staff is opposed to the inclusion of budgeted employee positions in the
22 payroll annualization. This is not a new position of the Staff.

Surrebuttal Testimony of
Janis E. Fischer

1 Q. What is the Staff's position on the proposed inclusion in annualized
2 payroll of Empire vacancies occurring because of internal transfers as referenced in
3 Mr. McKinney's rebuttal testimony?

4 A. The Staff does not support the inclusion in annualized payroll of vacancies
5 that are the result of internal transfers. The uncertainty of whether the positions will be
6 filled and, if filled, when they will be filled, means that these vacant positions should not
7 be accorded rate recovery for the associated payroll expense. Moreover, it is normal for
8 utilities to have a certain level of positions vacant at each point in time, due to internal
9 transfers, among other reasons.

10 Q. Does Empire have the management responsibility to reevaluate currently
11 filled positions in addition to reevaluating unfilled positions?

12 A. Yes. The recent Empire office closings at Columbus, Kansas; Gravette,
13 Arkansas; Greenfield and Republic, Missouri, are examples of management reevaluating
14 costs and deciding to reduce costs through the elimination of customer service offices and
15 the employees performing job functions in those offices. These Empire office closings
16 occurred after the test year and any positions eliminated through the closings will be
17 reflected in the true-up payroll annualization.

18 Q. How will the Staff determine the positions and salaries/wages to include in
19 the true-up at June 30, 2001 given the request made by Mr. McKinney in his rebuttal
20 testimony?

21 A. The Staff will review the last Empire payroll report generated prior to
22 June 30, 2001. This report will reflect the number of employees currently filling
23 positions at Empire and the amount of pay each employee was receiving for the last pay

Surrebuttal Testimony of
Janis E. Fischer

1 period prior to the end of the true-up period. The Staff will adjust the December 31, 2000
2 test year per book amount for payroll annualization to reflect positions filled and vacated
3 through the true-up period, which ends June 30, 2001. As agreed to in the prehearing
4 conference with Empire, the Staff will review documentation during the true-up for other
5 positions not reflected on the last payroll report. An example of a position not included
6 on the last payroll report would be a position for which an applicant has accepted
7 Empire's offer for a specific job but a pay check has not been issued to the employee as
8 of the last payroll report prior to June 30, 2001.

9 Q. What view related to payroll annualization was taken in the rebuttal
10 testimony of Empire witness Mr. Beecher?

11 A. On page 25, lines 19 through 23 of Empire witness Beecher's rebuttal
12 testimony, he states the following:

13 ...Operations expenses include items such as operating
14 labor. Empire has hired the majority of personnel at State
15 Line. Most of their labor has been capitalized as part of the
16 project costs through this time. When the unit is declared
17 commercial, the salaries for these employees will become
18 an operations expense....

19 Q. Has the Staff included expenses in the payroll annualization associated
20 with positions added to Empire's payroll directly as a result of the State Line Combined
21 Cycle (SLCC unit) plant addition?

22 A. Yes. Empire, in response to Staff Data Request No. 247, identified
23 28 positions that had been filled at the SLCC unit facility through December 31, 2000,
24 related to the operation and maintenance (O&M) of the SLCC unit. The Staff has
25 verified that these positions were included in Empire's final payroll report for the test
26 year, and they were included in the Staff's annualized payroll. While payroll costs

Surrebuttal Testimony of
Janis E. Fischer

1 associated with the construction of the SLCC unit were capitalized rather than expensed
2 during the test year, the Staff's calculation of the annualized payroll incorporates an
3 average expense factor for the years 1996 through 1999. The Staff believes this use of
4 the average expense factor adjusts for any unusual impact to the test year of capitalization
5 of payroll costs. This expense factor adjustment was discussed during the prehearing
6 conference and agreed to by Empire and the Staff. This adjustment in effect transfers the
7 capitalized portion of the payroll costs associated with the SLCC unit to expense in the
8 payroll annualization. Therefore, the Staff's annualized payroll reflects on a going
9 forward basis the cost of service associated with the SLCC unit employees for the test
10 year.

11 Q. Will the Staff include any additional employees hired at the SLCC unit
12 through the end of the true-up period?

13 A. Yes. The Staff will adjust the payroll annualization to reflect any
14 additional positions filled at the SLCC unit (or reductions in positions), according to the
15 criteria discussed earlier.

16 Q. How will the payroll expenses associated with the SLCC unit be adjusted
17 to reflect the shared ownership between Empire and Westar Generating, Inc. (Westar), a
18 wholly owned subsidiary of Western Resources, Inc.?

19 A. The Staff will allocate 60 percent of the payroll costs identified for the
20 SLCC unit employees to Empire. Westar will be billed the remaining 40 percent of the
21 costs associated with the SLCC unit employees similar to the billing procedure currently
22 used by Kansas City Power & Light Company (KCPL) for the Iatan generating station.
23 The Iatan station is owned 70% by KCPL, 12% by Empire and 18% by St. Joseph

Surrebuttal Testimony of
Janis E. Fischer

1 Light & Power Company (now a division of UtiliCorp). The 40 percent of SLCC unit
2 payroll costs allocated to Westar will not be included in the determination of Empire's
3 cost of service.

4 **BONUSES AND INCENTIVE PAY**

5 Q. Has Empire addressed the issue of bonuses and incentive pay in rebuttal
6 testimony?

7 A. Yes. Empire witness Mr. McKinney, on page 4 of his rebuttal testimony,
8 states that the inclusion of an additional incentive compensation (Incentive Award)
9 adjustment of approximately \$323,000 will be an issue in this case if it is not included in
10 the Staff's June 30, 2001 true-up calculation.

11 Q. When did the Staff first become aware of the \$323,000 Incentive Awards?

12 A. I first became aware of the Incentive Awards during the recent prehearing
13 conference, although it was referred to in testimony filed on February 16, 2001 in Case
14 No. ER-2001-452, Empire's interim rate increase case. Empire's responses to Staff Data
15 Requests Nos. 139, 139 Supplemental and 271 did not differentiate or identify the various
16 components of Empire's discretionary incentive compensation. The Staff issued Staff
17 Data Request No. 318 on April 26, 2001 to gather additional information to determine
18 whether the Incentive Awards should be included in the annualized payroll calculation.

19 Q. Did you identify other incentive compensation and address it in your
20 direct testimony?

21 A. Yes. The initial response from Empire to Staff Data Request No. 139
22 identified and quantified the "Lightening Bolt" awards as incentive compensation. I did
23 not include these awards in the payroll annualization and addressed the reasons why the

Surrebuttal Testimony of
Janis E. Fischer

1 Staff took this position in my direct testimony. The Staff also identified approximately
2 \$300,000 of incentive compensation Merit Awards based upon Empire's response to
3 Staff Data Request No. 271. The Merit Awards were included by the Staff in the test
4 year payroll annualization because they represent permanent adjustments to employees'
5 base salaries/wages rather than incentive compensation.

6 Q. Has the Staff included the \$323,000 Incentive Awards in its payroll
7 annualization?

8 A. The Staff continues to review this issue. The Staff received a response to
9 Staff Data Request No. 318 on May 3, 2001 from Empire. This response includes
10 excerpts from The Empire District Electric Company Performance, Compensation and
11 Career Development Approach Employee's Handbook (Employee Handbook) and the
12 names of employees and amounts of Incentive Awards given in lump sum to Empire's
13 non-union employees for the years 1996 through 2000. The Employee's Handbook does
14 not identify specific individual criteria for the awards. The Employees' Handbook states
15 at page 1.5, in relevant part, as follows:

16 The "Incentive Award" (lump sum) can reward you for
17 meeting or exceeding your Incentive Objectives defined in
18 Part II. To qualify for incentive awards, you must have
19 been employed by the Company the entire performance
20 year.

21
22 Incentive Awards reward results that go beyond those
23 normally associated with a position. These results tend to
24 be fleeting; a project that results in a one-time contribution
25 to the Company's bottom line or a team that successfully
26 develops a process beneficial to the Company and then
27 disbands. Results such as these are more appropriately
28 rewarded on a one-time, lump-sum basis.

1 Part II – Incentive Objectives (page 1.2) states the following:

2 Incentive Objectives describe results which go beyond
3 those normally associated with your position that, when
4 accomplished, add significant financial, strategic or cultural
5 value to the Company. An Incentive Objective should
6 never be written simply as a means of giving an employee
7 more money. These objectives may be prioritized at the
8 beginning of the performance year and re-evaluated
9 periodically to determine if their order of importance has
10 changed or the objective itself needs adjusted. [Sic] It is
11 important for you to know which incentives are
12 strategically more important. Incentive Objectives should
13 be viewed as the projects, process improvements, team
14 assignments, etc. that continuously pull the Company into
15 the future.

16 Q. Has the Staff requested additional information from the Company related
17 to the Incentive Awards totaling \$323,000?

18 A. Yes. The Staff has issued Data Request No. 330 dated May 8, 2001 to
19 verify a statement made by Empire's witness W.L. Gipson in testimony filed on
20 February 16, 2001 in Empire's interim rate case, Case No. ER-2001-452. In his direct
21 testimony in that case, Mr. Gipson stated that the \$323,000 Incentive Awards for
22 employee performance in the test year had been accrued and expensed in the year 2000.
23 If these awards are already included as expenses during the test year and it is determined
24 by the Staff that the Incentive Awards should be allowable, then the Staff would not
25 make an adjustment to Empire's cost of service to exclude Incentive Awards.

26 The Staff has requested specific documentation of Incentive Awards
27 criteria for a sample of Empire's non-union employees to assess the criteria upon which
28 the Incentive Awards are typically based. Until the Staff has the opportunity to review
29 this additional information related to the \$323,000 in Incentive Awards, a determination

Surrebuttal Testimony of
Janis E. Fischer

1 of what, if any, adjustment should be made to annualized payroll or any other general
2 ledger account affected by these awards cannot be made by the Staff.

3 Q. When will the Staff make its determination of the allowance of the
4 \$323,000 Incentive Awards?

5 A. The Staff will evaluate whether to include or exclude from Empire's cost
6 of service the \$323,000 Incentive Awards when the additional information requested is
7 received from Empire. At that time the Staff may file supplemental surrebuttal testimony
8 explaining its position if the issue of the allowance of Incentive Awards remains
9 unresolved with Empire.

10 Q. Please explain the Staff's treatment of the Company's discretionary
11 compensation award pool (i.e., the "Lightning Bolt" awards) and how that relates to the
12 Staff's ultimate treatment of the Incentive Awards.

13 A. In reviewing the "Lightning Bolt" test year costs, the Staff used the
14 criteria that an employee should not be granted additional monetary award for the
15 performance of normal job duties. Incentive compensation recovered from ratepayers
16 should only reward employees for performance that is both exceptional and beneficial to
17 ratepayers; in other words, employee performance that is beyond the employee's usual
18 job description and beneficial to ratepayers. To reward employees for activities that they
19 are required to do as part of their normal job duties would be duplicative and such
20 expenses should not be borne by the ratepayers. To the extent the Incentive Awards
21 given to Empire employees do not meet the above criteria, the Staff will recommend their
22 disallowance as it did with the "Lightning Bolt" awards.

1 Q. Would the Staff's evaluation of the \$323,000 Incentive Awards also
2 include similar criteria to that used by the Staff to determine the allowability of Empire's
3 Management Incentive Plan (MIP) in cost of service?

4 A. Yes. The Staff continues to follow the criteria outlined for incentive
5 compensation in this Commission's Report and Order in Case No. EC-87-114 respecting
6 Union Electric Company. In that case, the Commission stated in its Report and Order
7 that, at a minimum, an acceptable management performance plan should contain goals
8 that improve existing performance, and the benefits of the plan should be ascertainable
9 and reasonably related to the plan.

10 Similar to the Staff's MIP adjustment, the Staff will remove from cost of
11 service any awards related to Empire's attainment of a specified return on equity and/or
12 earnings goals, as well as for performance of any merger projects with UtiliCorp.
13 Meeting objectives related to attaining a certain return on equity and/or earnings goals, or
14 completion of projects related to the UtiliCorp rejected merger are of primary benefit to
15 the shareholders.

16 The Staff did not remove from cost of service MIP awards relating to
17 meeting electric O&M expense and fuel and purchase power goals because these goals
18 were of primary benefit to the ratepayers and, thus, in Staff's opinion, should be allowed
19 in cost of service. Likewise, goals that primarily benefit ratepayers will be allowed in the
20 determination of Incentive Awards included in cost of service.

21 Q. In the event the Staff recommends rate recovery of Incentive Awards, will
22 the Staff accept the test year level of Incentive Awards?

Surrebuttal Testimony of
Janis E. Fischer

1 A. No. Based upon Empire's initial response to Staff Data Request No. 318,
2 the level of Empire's incentive compensation has fluctuated over the last five years. The
3 Staff will use a five-year average of allowable Incentive Awards for the payroll
4 annualization, if the Staff determines that recovery of the Incentive Awards from
5 ratepayers is appropriate.

6 To set rates based on the test year amount of Incentive Awards would be
7 to assume that in future years the incentive plan objectives benefiting ratepayers will be
8 achieved to the same degree as accomplished for the test year in the pending rate case.
9 That would not be an appropriate assumption.

10 Q. Will the Staff update its position in relationship to the \$323,000 Incentive
11 Awards before the initial evidentiary hearings in this case?

12 A. The Staff will communicate its position to the Company on this issue as
13 soon as the additional information requested is received and reviewed by the Staff. The
14 Staff's criteria for the determination of whether to allow recovery in rates of the Incentive
15 Awards will not change from that stated in my testimony. The additional information
16 requested from Empire will permit the Staff to evaluate the appropriateness of allowing
17 the Incentive Awards to be recovered in Empire's cost of service.

18 Q. Does this conclude your surrebuttal testimony?

19 A. Yes, it does.

